OFFICE OF THE IDAHO STATE TREASURER

Julie A. Ellsworth, State Treasurer

DATE: July 14, 2020
TO: Alex Adams, Administrator, DFM, CFAC
FROM: Julie A. Ellsworth, Idaho State Treasurer
Patricia Perkins, Director, Dept. of Finance
SUBJECT: CFAC Funding Consideration

The continued safety and security of public tax dollars, by way of public deposits in Idaho financial institutions, is of the highest priority and of specific concern during times of economic uncertainty. **In the midst of the COVID-19 pandemic, securing uninsured public deposits is an urgent need.** The vast majority of states have a mechanism in place to secure uninsured public deposits—either through collateralization of uninsured funds at each depository that holds public funds or through a pooled collateralization program whereby depositories share the burden of protecting uninsured public deposits within the state. Idaho does not. **The Government Finance Officers Association states as a "Best Practice" that "deposits above the FDIC limit must be collateralized to ensure the safety of public funds".**

During the financial crisis and subsequent recession that followed in 2008-2009 many banks failed due to a lack of proper capitalization heading into an unprecedented collapse in financial and mortgage markets. During this time, the state of Idaho had two bank failures and the state of Washington had one of the largest bank failures in history—Washington Mutual. In all but one of Washington's bank failures, the banks were purchased by another bank and all unsecured deposits were honored. The one exception—Bank of Clark County—ended up with $15.1 million in unsecured public deposits that were covered by assessing the losses on a pro-rata basis to the other public depositories after the FDIC took over and sold all of the insured assets. (See footnote for additional background and remedies Washington put forth after 2009).

The economic landscape is shifting daily as a result of problems caused by COVID-19 and without some kind of backstop in place, Idaho's uninsured public deposits are exposed to real risks. The economic stresses caused as a result of COVID-19 will continue to put pressure on financial institutions for an extended time period—especially smaller regional banks and credit unions. The following is a non-exhaustive list of challenges these financial institutions will likely face in the wake of COVID-19:

1. An increase in loan delinquencies and a reduction in new loan origination due to consumer and small business financial strength deteriorating;
2. Sizable margin declines, especially for regional banks, with net interest margin potentially reverting to recession trough levels with the return of near zero-interest rate policy; and
3. Asset quality erosion amid widening credit spreads and dislocation in sectors such as energy and leisure

In 2010, the Department of Finance led efforts to form a task force comprised of a vast array of industry experts in both the public and private sectors to help solve this problem for the state of Idaho. This group was called the Public Depository Task Force ("PDTF"). The intent of the PDTF was to present legislation amending the Public Depository Law so as to include a mechanism for Idaho to protect its uninsured public deposits. During the timeframe that the PDFT was reviewing this issue, it was approximated by the Department of Finance that the amount of uninsured public deposits in Idaho's community-chartered banks alone was around $300 million. Unfortunately, the PDFT was disbanded before any legislation was proposed.

The State Treasurer's Office, in conjunction with the Department of Finance, would like to continue and build upon the efforts of the PDFT and requests the designation of $125,000 to support and enhance efforts to review current depository law and draft legislation that would protect Idaho's uninsured public deposits should there be a failure of a public depository. These efforts would include meeting with stakeholders to discuss potential viable solutions that would work for the state of Idaho, engaging external experts where necessary and ultimately proposing legislation for the upcoming legislative session. This is a complex, but necessary, undertaking. It will require a coordinated effort between multiple public offices and representatives of Idaho banks and credit unions. The State Treasurer's Office and the Department of Finance are committed to protecting public deposits without placing an onerous burden on Idaho's financial institutions.

The requested funds were not contemplated for this purpose before the COVID-19 outbreak and thus were not included in the FY2020 appropriation for the State Treasurer's Office or the Department of Finance. The State Treasurer's Office, with the support of the Department of Finance, proposes the following:

- **Creation of the "Public Depository Protection Fund**", which would be a new fund within the State's Idle pool, to receive the $125,000 ear-marked as CARES Act dollars (note: additional Idle fund accounts created would be managed by the State Treasurer's Office and have pro-rata ownership in the Idle pool, consistent with current operations). The State Treasurer's Office and the Department of Finance understand that these funds may need to be returned to the Treasury if they are not categorized as "incurred" on or before 12/30/20 The $125,000 is estimated to be incurred as follows:
    - $75,000 in direct payroll expense for 6 months to the State Treasurer's Office for one dedicated employee and a portion of payroll expense for additional employees' efforts
    - $50,000 available if needed to pay for external industry experts for legal and program review, as well as potential costs associated with the creation of a comprehensive database to track the financial health of Idaho's financial institutions through this COVID-19 related recession and on an on-going basis
- **Formation of a diverse group of stakeholders to begin the collaborative process of drafting a proposal, for the Legislature's consideration, that provides a long-term viable solution that protects uninsured public deposits, while not placing an onerous burden on Idaho's financial institutions.**

The Idaho State Treasurer's Office and the Idaho Department of Finance appreciate the support of the Governor's Office as we work on finding a solution to an urgent need to protect Idaho's public funds. We thank you for your time and consideration of this proposal.

Footnote (from 2009 Report to Washington State Legislature on Actions Taken by the Public Deposit Protection Commission):

On January 16, 2009, a failed bank holding more than $15 million in uninsured and uncollateralized public deposits triggered a first-ever assessment on other public depositaries to recover public funds that would otherwise have been lost. The 40-year-old Public Deposit Protection Act served its purpose and provided the necessary guidelines to recover the public tax-dollars lost in the closure but not without causing hardships for financial institutions. The unfortunate event also drove home the need for reform. Inaction would have jeopardized $8 billion in public deposits and the state's financial institutions. Swift and prudent action by the Legislature, Governor, the State Treasurer and regulators has reigned in the systemic risk to public deposits and the financial system. The Office of the State Treasurer is pleased to report that as of June 30, 2009, public deposits that previously could have been lost are now either fully insured or fully collateralized. By working together, we have created better protections for public deposits while also reducing risks and liabilities for financial institutions. With unemployment levels already

The 2009 Legislature unanimously passed Substitute House Bill 2061 to address systemic risks to state and local government public deposits and financial institutions that came to light during the financial collapse of 2007-2009. The measure provides greater discretion to the Public Deposit Protection Commission (PDPC) and additional authority to the State Treasurer. It facilitates the efficient and effective implementation of new reporting, rulemaking and administrative requirements for banks, savings banks, and savings associations. With this additional authority and agility, the PDPC and Treasurer can respond to rapid changes in both the economy and the condition of financial institutions. On March 6, 2009, Gov. Chris Gregoire signed SHB2061 and it took effect immediately. The PDPC and the Treasurer then acted quickly to reduce the risk that an individual bank failure would jeopardize public tax dollars and the broader network of financial institutions authorized to accept public deposits. The new law requires the State Treasurer to provide an annual report to the Legislature on actions taken by the Commission and the State Treasurer regarding public deposit protection. In compliance, this report is intended to provide an accounting of the issues and actions taken by the Public Deposit Protection Commission and the State Treasurer to protect public deposits. It also summarizes the outcomes and emerging issues as of August 23, 2009, the date new, updated rules and procedures took effect for financial institutions that hold public funds.